DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 15196
San Diego, California

40 Letters per Year — $50.00 Annually

Registered with the Securities Exchange Commission

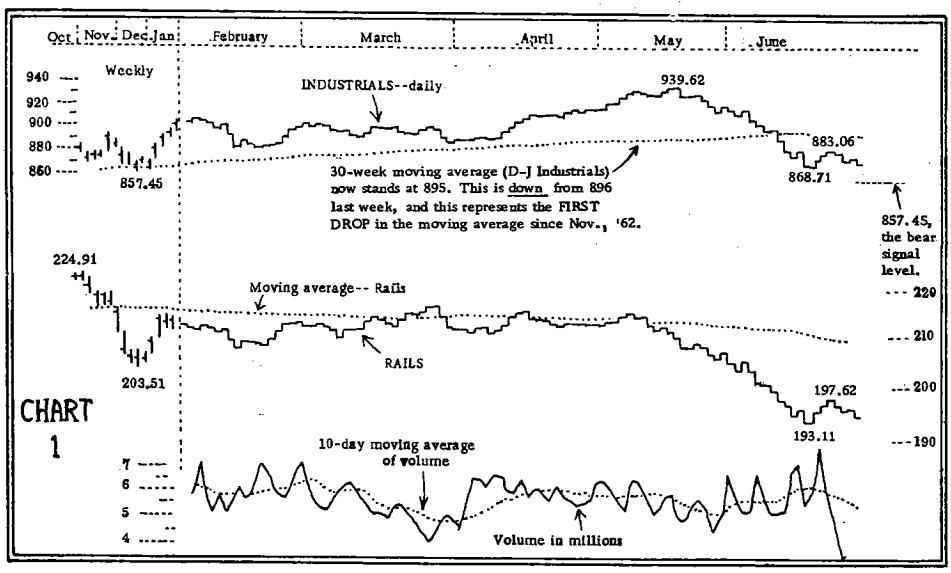
June 24, 1965 Letter 292

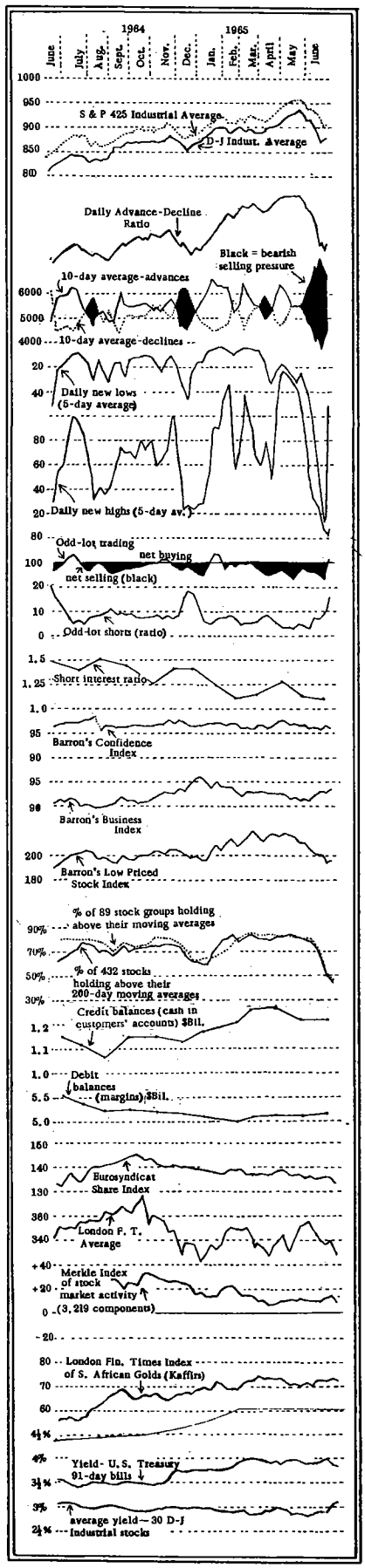
THE MARKET: Regardless of how many times I go over the theory of the primary trend, a majority of subscribers (both old and new) fail to grasp its full significance. The single most important question regarding the market at this time is whether the primary trend turned bearish last October 20 (when the two Averages recorded their last confirmed highs) or whether all the weakness since October has merely been part of a secondary reaction within a still intact primary bull market.

All of us know of a few analysts who have been bullish over perhaps the past decade. One particular well-known market advisor has been consistently bullish since 1949. Each time the market has tumbled over the past 16 years this analyst has come forth and boldly predicted new highs for the Averages — often the forecasts were issued near the bottom of a reaction (such as 1957 or 1962) when such predictions seemed least likely to succeed. How could this man have foreseen new highs at say the depths of the panic stage of 1962? There was only one way, and this is that he fully understood the concept of the primary trend and he was convinced that the primary trend was still bullish. For regardless of the severity of a reaction, if the primary trend is still bullish — then by definition the two Averages will ultimately push to new bull market highs.

Many subscribers are asking me whether Johnson can prevent a bear market, whether the Federal Reserve Board or the Treasury can "do something" to avoid a bear signal over the period ahead. My answer is this: If the primary trend is still bullish, then I don't care who does what, the Industrial Average will not break the 857.45 low (in other words, a bear signal will not be given). But if the primary trend turned bearish last October, then regardless of what President Johnson, Congress or anybody else does, Industrials are going through the 857.45 Industrial low.

It is important to remember that the Dow Theory is largely a device for classifying the trend of the market. There are a thousand methods of guessing or attempting to "figure out" the direction of the primary trend. The Dow Theory tells you whether your prior guesses were correct or not. To put it another way, the primary trend turned bearish on September 3, 1929. A few market students suspected as much, but there was not a man alive could prove it. On October 23 a bear signal was given by the Averages. That bear signal (coming almost two months after the extreme top) told Dow Theorists that the tide had turned. The bear signal confirmed the earlier inferences of the bears. Again, a bull market started on June 13, 1949. Many intelligent investors suspected as much and purchased large quantities of stocks all during 1949 and early 1950. But the Dow Theory did not signal a bull market until October 2, 1950. This may seem like a long time to wait, but I can assure subscribers that the





October 2 bull market confirmation looked awfully good to those who had nervously carried stock up from the 1949 lows.

The great post-war bull market started in 1949. Despite numerous severe reactions, nothing resembling a true bear market has been seen in the past 16 years. When I talk about a "true bear market" I want subscribers to know that I am thinking of a series of declines and retracements which will serve to correct the entire 778 point rise since 1949. The market has been buffetted by many severe slides since 1949, including those of 1953, 1957, 1960, and 1962. Following October, 1962, the Averages advanced in harmony for exactly two years. The Rail Average recorded its peak on October 26 at 224.91. During the seven months subsequent to October, 1964, we saw one of the most striking periods of divergence in the history of the Averages. Industrials touched a new record peak (939.62) as late as May 14 (see Chart 1), although Rails were at that time in an established and dangerous downtrend. In late May and early June the "out-of-gear" action of the Averages proved too much for the market. Within a period of a month (May 14 to June 14) the Averages tumbled while the mass of issues (as measured by the A-D ratio) sustained one of the severest waves of selling on record.

ASIA AND THE MARKET: In the investment business it is an utter necessity to be able to face facts regardless of whether those facts are pleasant or unpleasant. Many observers, for instance, are convinced that the Vietnam situation will at worst be another Korea. But if the developing facts belie this thesis, it will be necessary for all of us to undergo a drastic change in thinking.

All problems, unfortunately, are not amenable to an easy solution, and some problems seem to behave much like a stranded truck on the California desert; the more frantic the efforts to extricate the vehicle, the further it digs itself into the sand.

It seems to me that the Vietnam situation is becoming just such a great, worrisome, insoluble problem (see Letter 287). The Johnson policies in Vietnam are now (ironically) strongly supported by the Republicans and many "right wingers," they are listlessly or apprehensively backed by the majority of the American people, they are vigorously opposed by the "left wing" and the "university intelligensia." The reason for each group's support or rejection of the Administration's policies sound depressingly convincing. No single group appears to have a monopoly on the truth or the right answers. "President Johnson seems a little solemn these days," notes James Reston in the New York Times (June 13) in a half-hearted plea for the President and his policy, "but neither falling governments in Saigon, nor squabbling politicians in the Dominican Republic, nor complaining critics in Washington and the other allied capitals have persuaded him that his policy is wrong in the Caribbean or Southwest Asia."

As this writer sees it, the South Vietnam "government" is almost non-existent and South Vietnam morale is now very low. This deteriorating situation increasingly implies an ultimate American takeover of the war, a war which, when the French fought it earlier, produced 75,000 dead or missing Frenchmen and 65,000 wounded and ended in defeat and withdrawal. "If the South Vietnam military forces crack and the U.S. takes over more and more of the fighting," warns the leftist New Republic (June 19), "it will take, according to the 10 to 1 ratio rule, about 1.5 million Americans 5 to 10 years to 'win' a war that will stay 'won' only as long as the Americans stay."

Unquestionably the Vietcong now believes that it is winning the war in Vietnam. As a result, the Vietcong does not (at this point) entertain the remotest thought of negotiating with the Americans. The Americans are now far too heavily committed in Vietnam to withdraw. Yet the Administration continues to hope that somehow a continuation of the bombing will force the Vietcong to reconsider and negotiate. What is the answer? As far as I can see, this is the most distressing question of all, because neither I nor anybody else sees any intelligent answer at this time. But I do see the Vietnam situation exerting increasing pressure on the stock market, pressure which will intensify as the extreme seriousness of the Vietnam situation begins to dawn on Wall Street and Main Street. So far, the stock market has taken the entire Vietnam situation pretty much in stride. But "in stride" could well be another way of spelling "unwarranted complacency."

On May 27 the D-J Rail Average closed below its December low of 203.51. I noted at the time that "one half a bear signal" had been given, and I further noted that one half a signal was hardly better (from the standpoint of predictive value) than no signal at all. By June 14 Industrials closed at a low of 868.71 — just 11 points above the bear signal level. The plunge continued through June 15, but on that day (amid volume of 8.4 million shares) a dramatic noon reversal occurred, and the Industrials actually closed up over 5 points on the day. A bear signal had been averted.

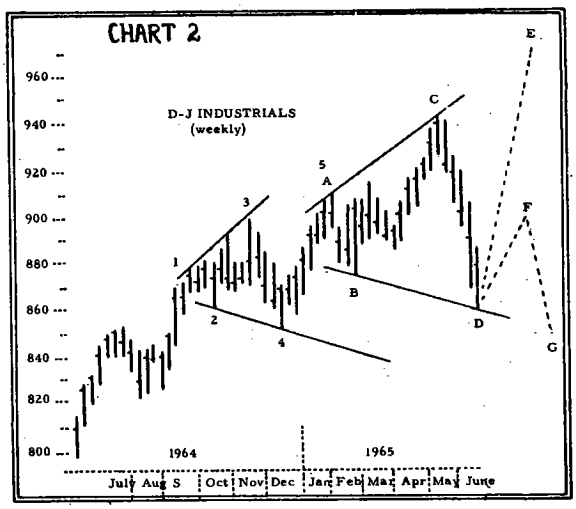
What can we say about the market at this time. First, just as a major non-confirmation existed following October, 1964 (during which time Rails refused to confirm the advancing Industrial Average), so a non-confirmation is now in effect on the downside — with Industrials (at least so far) refusing to confirm Rails on the downside. It is too early to jump to conclusions (in other words, Industrials might still plunge below the 857.45 level), but the longer Industrials hold, the better the odds that the market is putting itself in position to retrace at least part of the May-June losses. A normal 50% retracement of the 72 points lost (939.62 to 868.71) could take Industrials back to the 899 level. This type of "normal" retracement (I am always afraid of talking about "normality" in regard to the market) could take Industrials back to about the area of the 30-week moving average.

Question: From the very near-term standpoint, what are you looking at now? Answer: I am watching the June 14 decline lows of 868.71 and 193.11. As long as one or both Averages hold above those levels, there is a good chance that the secondary trend is turning up. Conversely, a breaking of the 868.71 and 193.11 points (on increasing volume) would almost surely lead to a bear signal. On the upside, I am watching the June 17 minor highs (see Chart 1) of 883.06 and 197.62. A bettering of both of these points would point the secondary trend up. But a non-confirmation on the upside (i.e., one Average refusing to better the June 17 high while the other pushes out) could be dangerous.

Question: Aside from orthodox Dow Theory retracement principles, what other comments would you venture regarding a potential recovery from here? Answer: Obviously, all I can offer is some educated guesses, but there are a few things of interest which I want to bring to the attention of subscribers. It should be remembered that the market often does the "unexpected," and if this is to be the case I want subscribers to be prepared.

Study the weekly chart of the Industrial Average (Chart 2). Here we see a most interesting picture of successive rallies and declines, each tending to outdo the last both in violence and amplitude. Note that the September, 1964 to January, 1965, series of swings (numbered 1 through 5 on chart) present the appearance of a "broadening formation." The broadening formation is a rare 5-point reversal pattern in which each peak pushes above the last peak and each low dropes below the preceding low. Generally, such patterns are bearish in import. They are a product of "whipped up" emotions and violent reversals in speculative sentiment.

CHART 2



The broadening "tendencies" in the Industrial Average should be accepted as a warning regardless of whether the market now rallies or falls away. This type of pattern is indicative of a market which can become violent, then calm, a market that can rally then reverse "on a dime."

Note that following point 5 on Chart 2 (Page 2), a decline carried to point B. The decline thereby halted well above the lower trendline (2-4), and it should be noted that a penetration of the lower trendline would have carried extremely bearish implications. From B, Industrials ran up to a new high at C, only to fall precipitously under the preceding B level. In so doing, Industrials formed the lower trendline B-D. The point D corresponds to the June 14 Industrial low at 868.71.

Thus the current A-B-C-D pattern is beginning to assume the appearance of another potential broadening formation. A rise from D to E (to a new all-time Industrial high) as shown by the dotted line would in effect produce the second broadening pattern since September. Such a high would undoubtedly "electrify" Wall Street and the nation, but I would treat it with utmost care. Another possibility (assuming a bear signal is now averted) is the D-F-G pattern which would actually be a "head-and-shoulder" effect with the A, C and F points corresponding to the "left shoulder," the "head," and the "right shoulder." In any event, the point I wish to make is that if a base is being formed here (in other words, if we avoid a bear signal) I view this area as one for trading purposes only. An advance from here could be half-hearted as per D-F-G or it could be "impressive" as per D-E. In either case, the way ahead will be a tenuous one, and if it is used it should be used for trading purposes only.

AS SUMMER ENTERS: The writer trades subscriptions with a number of other services. I have only one stipulation in this exchange process, and that is that I must have the highest respect for the ability and integrity of the other analyst. Obviously, some of us must always be right and some must be wrong. But I periodically present the views of a few of these other analysts for the benefit (or at least interest) of my subscribers.

Garfield Drew (Drew Odd lot Studies) states in this week's report that he believes we are seeing an intermediate decline probably within the context of an extended top formation. Drew notes that only once in the last 100 years has the year's high been made in May. Although this move may go lower before bottoming, Drew does not see the elements now for a continued full collapse.

Joseph Granville believes a bear market is in progress. Noting the preponderance of the "we're near an important rally" opinion, Granville takes the unconfortable position that there is a mountain of supply above this market, and he further states that from a "contrary opinion" standpoint, a good case could be made for no important retracement from this level. His summary: "Stay bearish."

Eliot Janeway turned bearish quickly when Martin tightened up on the money supply a few months ago. Janeway's opinion: a better than 50/50 chance that the Dow will break 857, but he believes the bull market could reassert itself from a lower level — say 850. What the Administration does from here, he feels, will be "decisive."

E. George Schaefer believes this is a reaction in a bull market which still has not breathed its last. He feels that the lows are close or at hand for this reaction and that the market will still rally and approach what he terms his 950-975 "danger area." Use any rally between here and late summer and fall to give your stocks (and he means everything) back to Wall Street warns Schaefer, who is preparing a new report entitled "The Coming Depression." Schaefer is anything but bullish for 1966 and beyond.

Don Worden who is the originator of the "big money" indices does not show (or at least his indices do not indicate) a bear market yet. He has no evidence to prove (at this point) that a bear market has started or that the reaction is definitely over.

James Dines, a leading point & figure analyst, notes that as far as his major rising trendline is concerned, "the back of this bull market has been broken." He concedes that the market appears "oversold" from a short term standpoint, but even a new high on the Dow cannot erase the fact that this major trend on Industrials has been ruptured for the first time since the advance began. "While odds are against a straightline decline from here, we never fight a trend for long, and it is pointed down at this time."

While the new Bolton (bank credit) report will not be out until the end of the month, Mr. Bolton conceded in his last report that his indexes could turn bearish in July. His technical market studies and momentum indexes (at last reading) had not yet turned bearish, so we will have to wait for July for the latest from the widely-respected Mr. B.

Chartcraft, a second important point & figure service, notes that it usually receives two Dow signals prior to the end of a bull market. So far, it has only received the first in the early breakdown of the Dow (see last Letter). Chartcraft expects another Dow rally to around 960, regardless of what the rest of the market may do from here on. Chartcraft also notes that they usually receive 7 sell signals from 7 indicators before a major top and so far none of these has materialized. The 7 indicators: (1) S & P's Low-Priced Stock Index (2) a drop in the short interest to the 4 million level (3) a sell signal in the Air Transport group (4) sell signal in a 3-group composite made up of Metal Fabricating, Sulphur and Sugar (5) sell signal in their 46-month momentum index (6) a shift to odd-lot buying (7) a definite N.Y.S.E. volume peak. So they are not bearish yet.

Question: If we avoid a bear signal, you say we could get a "retracement" — perhaps even a move towards the May highs on the Dow. Fine, but what about the rails and most other stocks? Answer: That's the catch. I don't think the Rail Averages are going to get back to their 1964 high of 224.91 on a rally, and I would guess that the A-D ratio (and therefore most stocks) has also "topped out."

Question: Come now, Russell. If that's the case then you're telling us that we'll probably be seeing some sort of unconfirmed rally in a bear market. Answer: Yes, it's my guess that we could be in the early stages of a bear market.

Question: Well, would you "play" such a rally? Answer: Personally, I'd be extremely careful, but it's up to the individual. For the average subscriber I would say that he would be better off using such a summer rally as a chance to clean out everything, get his "house in order," sell that car or house or extra acre or whatever he was planning to sell "next year," and prepare for a bear market. He might also use any substantial rally from here to purchase (and this again is subject to individual taste) discounted put options as outlined in Letter 290.

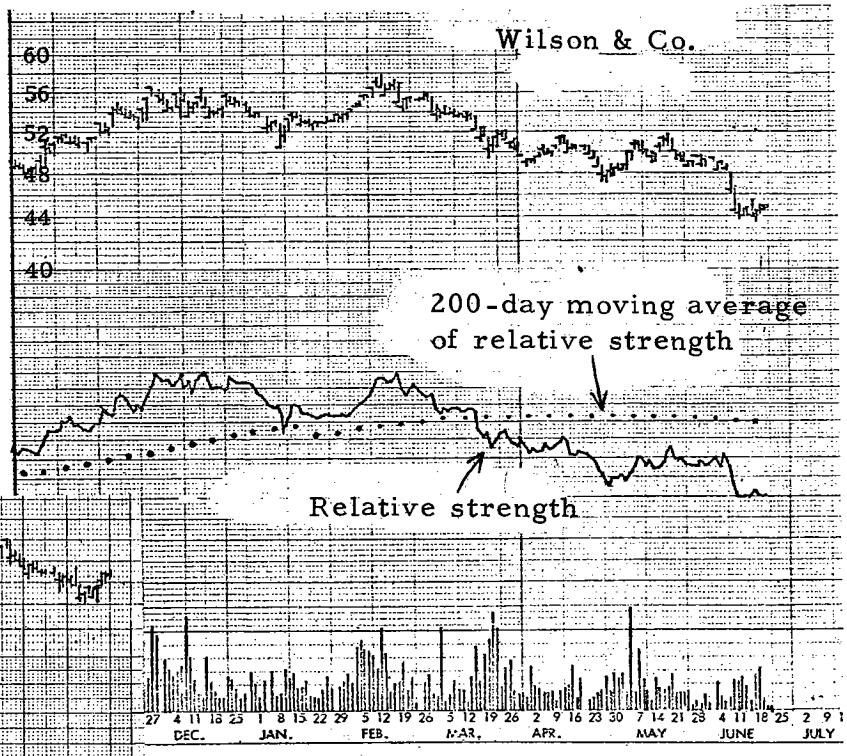
Question: If we're in the early stages of a bear market, wouldn't you expect more evidence? Things are still too orderly, too happy. How do you explain this? Answer: The early stages of a bear market are often orderly. Thus, the first swing down in early to mid-1937 was orderly, and the panic stage did not occur until after the bear signal (even though technically the bear market started in March, 1937). The same could be said, for instance, during 1949 and 1950 on the bull side. During 1949 and 1950 everything looked very risky and uncertain, even though one of the greatest bull markets in history had actually started in June, 1949.

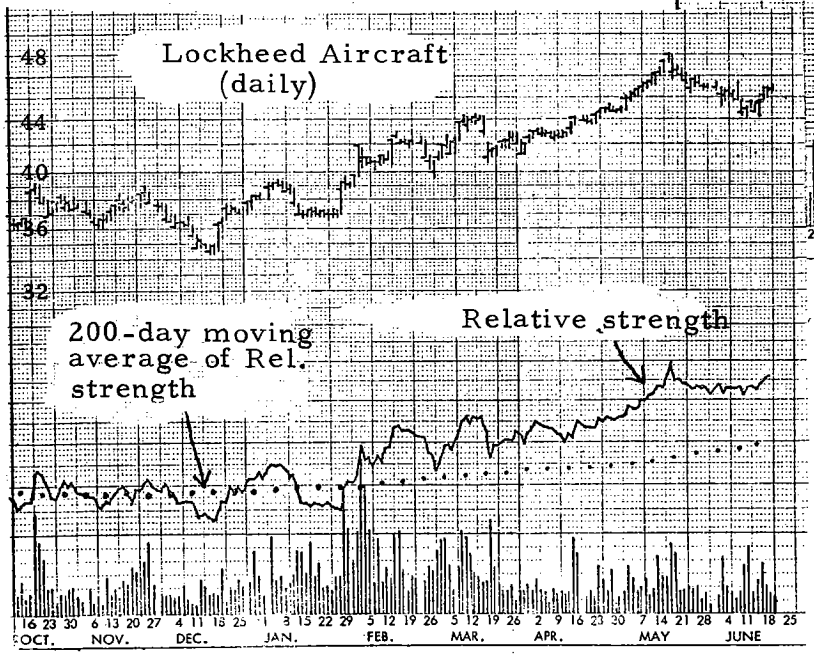
Question: Is there anything in the Averages now that bothers you? Answer: Yes, any chart will show that the Rails have broken down from an obvious "head-and-shoulders" formation. And as noted in this Letter, the Industrial Average is now showing "broadening tendencies."

The Composite (Page 1) Chart shows the two leading Industrial Averages halting above their December lows, an action emulated exactly by the A-D ratio. Selling pressure, as seen by the black area of the 10-day average of daily declines, is still much in evidence, but the maximum intensity may have (at least temporarily) passed. New highs and lows require little comment here. A few days of heavy buying has caused the Odd-lot indicator to push into the buy zone, but people cannot seem to understand that it is normal for odd-lotters to buy heavily on the first rebound following a sharp sell-off. Odd-lotters did increase selling on the decline, however, and this is constructive. The Odd-lot short index is now rising, another hopeful short-term sign. The declining trend in Barron's Confidence Index and the Short Interest ratio are hardly cause for long-term bullishness at this time. The Percentage of 432 Stocks holding above their moving averages dropped to 44% this week, which turns this important indicator bearish. The Eurosyndicat Index has dropped to a 1965 low of 134, and this underlines the broad weakness which is now rocking foreign exchanges throughout the world. Volume on foreign exchanges has dried up drastically, due to the mass exodus of the public. Last week it was announced that only 2 out of the 94 brokerage houses in Japan are operating at a profit, despite syndicate efforts to "support" the Japanese Exchange. Again last week it was reported that supports may soon be placed under the slumping French market. I take a dim view of the total foreign stock exchange picture, and as a point of interest I have included (from the June 25 London Economist) a table of 8 foreign averages showing the percentage drop in each from its bull market high. "Excuses" to explain the sundry declines are not lacking. Mr. J. Merriman, a student of international markets from Ventura, California, writes me: "In France it is the squeeze on industry; in Germany fear of a left-wing victory in the general election; in Italy disappointment with the reflationary programme; in Japan the failure of the official attempt to support a demoralized market ... the severe fall on Wall Street is attributed to Vietnam and now to a notoriously disquieting speech by Mr. Martin." The London stock average (see chart) is now flirting with its last major low point, and a drop to the 320 level would be taken as extremely bearish for London (in a primary sense). The gold shares are marking time within shooting distance of their 1965 highs, as seen by the Kaffir Index. CONCLUSION: The long-term warnings are plain to see in the indicators.

	Latest price	% Change from the peak	Bull market high
London*	375·6	−13·0	Oct. 1, 1964
New York	878·1	− 6·5	May 14, 1965
France	82·3	−39·3	April 25, 1962
Germany	94·6	−32·6	June 7, 1961
Italy	54·4	−53·3	June 21, 1961
Switzerland	209·7	−23·9	Sept. 13, 1963
Canada	163·2	− 6·2	May 13, 1965
Australia	307·8	−18·8	Feb. 27, 1964
Japan	1,062·7	−38·9	Aug. 16, 1961

STOCKS: Relative strength (RS) refers to the performance of a given stock as compared with the general market. In the last Letter I stated that "RS is of greatest use during important declines. Stocks that consistently outperform during a declining market (even though these stocks may actually be declining themselves) are often the leaders on the next advance." I might have added the converse, which is that stocks which register poor performances during general market advances are usually the leaders on the next general decline. The rationale for this is simple — RS trends tend to be very persistent (they continue whether the market advances or declines). The weakness in an individual stock which so often goes unnoticed during a market advance (the given stock may rise only slightly while the market is surging) becomes quickly apparent during a market decline when the same weakness in the individual stock may give way to a more dramatic collapse.





The use of RS is dramatically demonstrated in the performance of two issues as shown on the accompanying charts (charts courtesy of Traders Research, 1431 Pearl, Alton, Ill.), Lockheed (from Letter 291's listing of "strong stocks") presents a remarkably strong RS picture. Note that LK's RS line is holding well above the 200-day moving average of RS (dotted line). The strength in LK was much in evidence last week, when despite sinking tendencies in the general market LK held within a few points of its high for the year.

On the other hand, Wilson's RS line broke down in March, and that trend continued. When the general market turned weak in May-June Wilson dropped dramatically from 52 to 44 within a matter of a month. What had occurred — Wilson's weak RS performance had merely held intact.

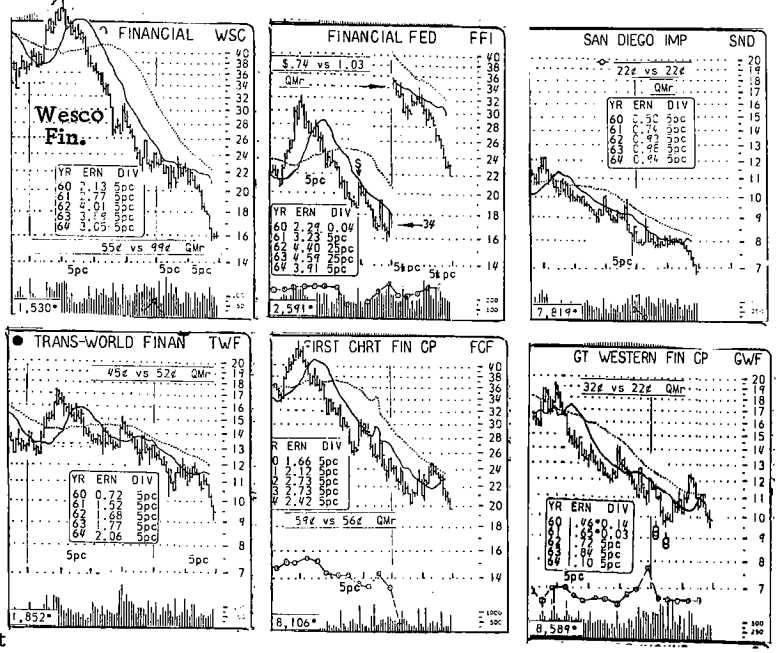
I have again reviewed many hundreds of stocks with extreme care. The following issues are showing outstanding RS patterns: Lockheed, Reynolds Metals, Alcoa, Nat. Cash Register, AMP Inc., Vairan, Gen, Instr., Electron.Specialties, Amer. So. African, Colo. Fuel, Burlington, Beauknit, BVD. The Aluminum and Electronics and Textile groups are particularly strong.

For the long-term, I have been recommending "discounted puts" as per Letter 290. Subscribers have been asking for a "recommended list" suitable for puts. I submit the following five stocks, each of which is now showing poor RS, each of which has topped out, and each of which is suitable for a one-year discounted put. The five stocks are Chrysler, Deere & Co., Corning Glass, Illinois Central R.R., Jones & Laughlin. Remember, put options are easiest to buy on a rally, and they should always be purchased for the long-term, over six months put I prefer one year.

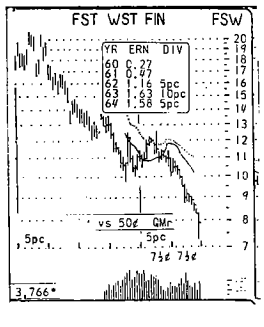
Referring to the DJI stocks, there has been no change since Letter 291 with 13 DJI stocks still bullish and 17 bearish. Strongest stocks in the Dow are Alcoa, Amer. Tob., Anaconda, Int. Nickel, Westinghouse, Woolworth.

* * * * *

SUNDRY COMMENTS: When I first moved out to San Diego from New York four years ago, I visited the local real estate offices in a search for a house to rent. "Are you kidding?" was the unanimous retort from local real estate men. "Prices on houses are rising every week. Forget about renting and buy before houses sky-rocket completely out of reach." In general, anyone who wanted to rent in 1960-61 was treated like a leper. I rented. Times have now changed, and houses for sale, rent or anything you want are a dime a dozen in San Diego. Wall Street has a way of protecting itself before the news. One year ago (Letter 256) on June 11, 1964, I directed subscriber's attentions to the early cracks in the savings & loan stocks. These are the companies and holding companies which have financed the largest part of the massive building program in California. These companies hold billions in mortgages and real estate. The S & L's are the most important stocks in the most important industry in the nation — the building industry.



In view of this, I again want to show what is happening here. It's not a pretty sight. I include charts of 7 typical S & L stocks and here we see issues which, although they have already lost anywhere from 35 to 75% of their peak value, are still collapsing. (Charts courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas). What is the market telling us? My own guess — there is trouble ahead for the massive building industry, and I think that trouble is going to include rising delinquencies. When a group of stocks "fall apart" the way these S & L stocks have, it is Wall Street's way of saying "watch out." The bad news for the building industry is coming, and judging from the profiles of these 7 stocks it's going to be mighty bad. This, by the way, constitutes my personal warning for subscribers who have real estate interests.



When a big New York real-estate firm heads for bankruptcy; when the largest credit union in Minnesota is being placed in receivership; when a number of banks around the country fail and a great many others put out shaky loans; when the pressures build for higher wages and prices—when all that is visible, we think it reasonable to conclude that there is quite a credit spillover in the domestic economy.

Evidently I am not the only one who is worried about the credit situation. In an editorial (June 23) in the Wall Street Journal entitled "Credit on the Rocks" the clip above proved of more than passing interest.

LATE NOTES: (Written Thursday, June 24, 11 A.M. as the market is sagging badly). Volume during June 21-23 was the lowest in over a year. Dullness in a bull market usually identifies a "buy spot." But the situation is reversed in a bear market, and during a bear market dullness is generally the preamble to the next decline. It is a depressing fact that this market is beginning to act like a bear market. The decline since the May 14 Industrial peak is also exhibiting one outstanding characteristic — it is producing no rallies worthy of the name.

This Letter ends in the same manner as the last Letter (291), with Industrials sinking to within "shooting distance" of the 857.45 bear signal level. For many years this generation of investors have been told that no true bear market could materialize because of the "pressure for investment of institutional funds." The test of that thesis is, in my opinion, close at hand.